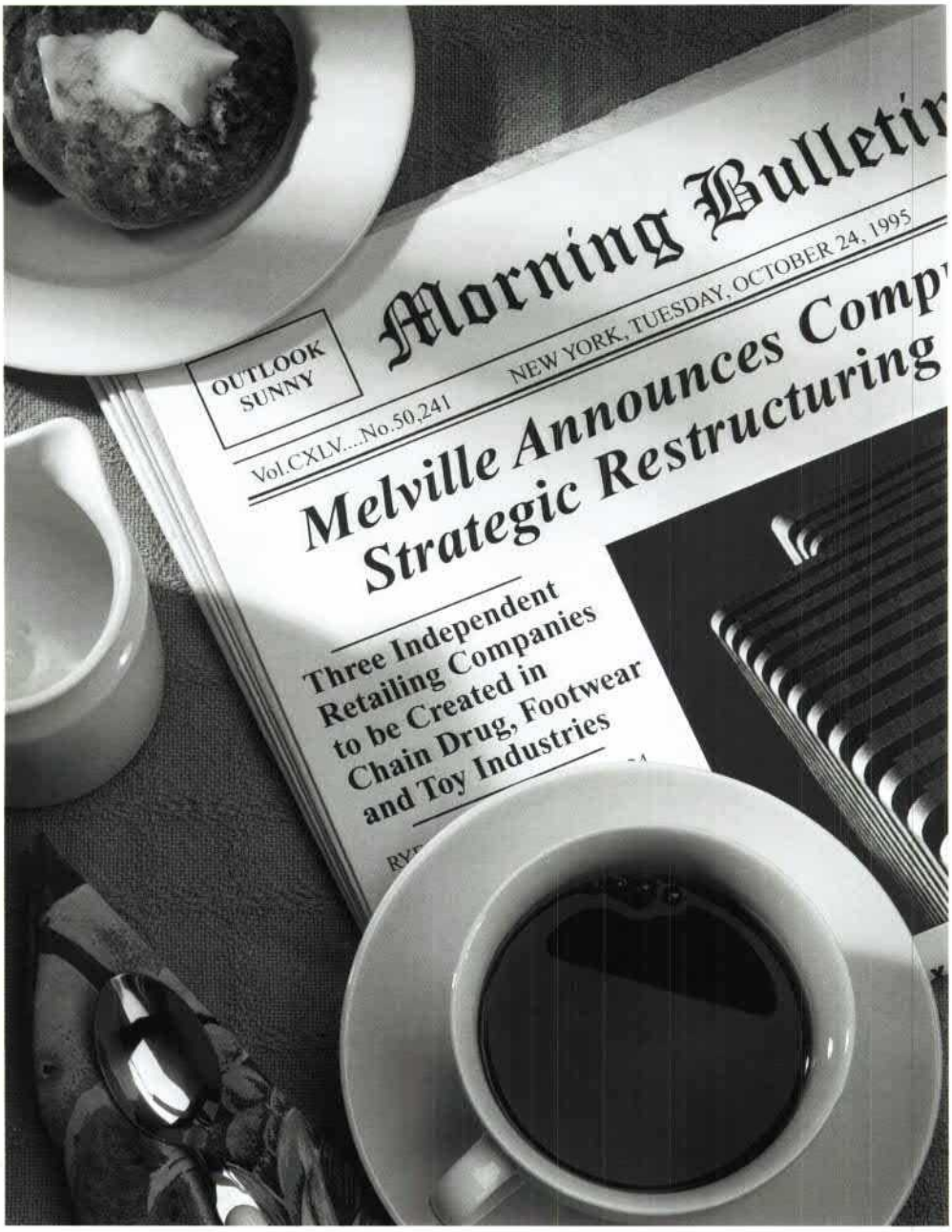
Melville



1995
Annual Report

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About 1995

Melville has embarked on a new course. The restructuring program is underway, and our focus is clear: "We believe this strategy will enable us to resume our historic pattern of growth and, in turn, build greater value for our shareholders."

Financial Highlights

(in thousands, except per share data)			
Operating Results [1]	1995[2]	1994	% Change
Net Sales - Continuing Operations	$9,689,062	$9,445,678	2.6
Same Store Sales Increase	2.2%	3.5%	
Operating (Loss) Profit - Continuing Operations	$ (742,791)	$ 450,264	(265.0)
Net (Loss) Earnings	(657,106)	307,470	(313.7)
Dividends on Common Stock	159,943	160,422	(0.3)
Dividends on Preferred and Preference Stock	24,351	24,929	(2.3)
Per Share of Common Stock			
(Loss) Earnings from Continuing Operations before Cumulative Effect of Change in Accounting Principle	$ (6.02)	$ 2.15	(380.0)
(Loss) Earnings before Cumulative Effect of Change in Accounting Principle	(6.01)	2.75	(318.5)
Net (Loss) Earnings	(6.41)	2.75	(333.1)
Dividends	1.52	1.52	–
Financial Position at Year End			
Cash and Cash Equivalents	$ 129,583	$ 117,035	10.7
Inventories	1,672,957	2,138,243	(21.8)
Working Capital	762,240	1,007,757	(24.4)
Shareholders' Equity	1,547,763	2,381,605	(35.0)
Statistics			
Weighted Average Common Shares Outstanding	105,081	105,481	(0.4)
Number of Stores - Continuing Operations [3]	3,335	3,838	(13.1)
Number of Stores - Total Company [3]	6,657	7,378	(9.8)
Number of Associates	96,832	117,414	(17.5)

(1) In accordance with APB Opinion No. 30, the Footwear segment has been classified as discontinued operations for the purpose of presentation in the 1995 annual report.
(2) Operating loss and net loss figures reflect the impact of special charges and asset write-offs.
(3) Includes stores designated to be closed in the first quarter of 1996 as part of the Company's restructuring plan.

Total Company Data for Informational Purposes[4]			
Net Sales	$11,516,376	$11,285,561	2.0
Same Store Sales Increase	1.4%	3.3%	
Operating Profit before Special Charges [5]	$ 293,171	$ 610,742	(52.0)
As a Percent of Sales	2.5%	5.4%	

(4) Inclusive of the Footwear segment.
(5) Special charges include restructuring and asset impairment losses recognized upon adoption of SFAS No. 121.

Melville at a Glance

($ in thousands)	Net Sales 1995	1994	% Change	Number of Stores 1995(e)	1994	1995 Average Square Footage
Prescription Drugs, Health and Beauty Care						
CVS (a)	$ 4,865,025	$ 4,330,099	12.4	1,366	1,328	8,900
Apparel (b)						
Marshalls	$ 2,253,391	$ 2,774,851	(18.8)	–	484	–
Wilsons	453,294	475,123	(4.6)	548	628	2,600
Bob's	348,966	288,954	20.8	34	20	46,200
Toys and Home Furnishings						
Kay-Bee	$ 1,077,297	$ 1,012,164	6.4	1,004	996	4,300
Linens 'n Things	555,095	440,118	26.1	155	145	23,800
This End Up	135,994	124,369	9.3	228	237	1,400
Total Continuing Operations	$ 9,689,062	$ 9,445,678	2.6	3,335	3,838	
Footwear						
Meldisco	$ 1,191,531	$ 1,280,527	(6.9)	2,568	2,778	3,400
Footaction	423,743	332,294	27.5	439	439	3,300
Thom McAn	212,040	226,874	(6.5)	315	323	3,200
Manufacturing (c)	–	188	–	–	–	
Total Discontinued Operations	$ 1,827,314	$ 1,839,883	(0.7)	3,322	3,540	
Total Including Discontinued Operations	$11,516,376	$11,285,561	2.0	6,657	7,378	

(a) Interdivisional sales of $66,068 and $3,478 have been eliminated in 1995 and 1994.

(b) Reflects the sale of Marshalls as of November 17, 1995.

(c) Interdivisional sales of $4,609 have been eliminated in 1994; operations ceased July, 1994.

(d) Before corporate expenses and special charges.

(e) Includes stores to be closed in the first quarter of 1996 as part of the Company's restructuring program.

(f) Special charges include restructuring and asset impairment charges.

Segment Summary

	1995	1994	% Change
Prescription Drugs, Health and Beauty Care			
Net Sales	$4,865,025	$4,330,099	12.4
Percent of Continuing Operations	50.2%	45.8%	
Operating Profit before Special Charges (f)	273,503	227,655	20.1
Percent of Continuing Operations	104.2%	46.6%	
Percent of Total Including Discontinued Operations	75.0%	35.1%	
Apparel (b)			
Net Sales	$3,055,651	$3,538,928	(13.7)
Percent of Continuing Operations	31.5%	37.5%	
Operating (Loss) Profit before Special Charges (f)	(72,623)	161,087	(145.1)
Percent of Continuing Operations	(27.7)%	33.0%	
Percent of Total Including Discontinued Operations	(19.9)%	24.8%	
Toys and Home Furnishings			
Net Sales	$1,768,386	$1,576,651	12.2
Percent of Continuing Operations	18.3%	16.7%	
Operating Profit before Special Charges (f)	61,686	99,403	(37.9)
Percent of Continuing Operations	23.5%	20.4%	
Percent of Total Including Discontinued Operations	16.9%	15.3%	
Operating Profit - Continuing Operations (d)	$ 262,566	$ 488,145	(46.2)
Footwear			
Net Sales	$1,827,314	$1,839,883	(0.7)
Operating Profit before Special Charges (f)	101,953	160,476	(36.5)
Percent of Total Including Discontinued Operations	28.0%	24.8%	
Total Operating Profit Including Discontinued Operations (b)(d)	$ 364,519	$ 648,621	(43.8)

To Our Shareholders

ON OCTOBER 24, 1995, WE ANNOUNCED A COMPREHENSIVE STRATEGIC RESTRUCTURING. WE BELIEVE THIS STRATEGY WILL ENABLE US TO RESUME OUR HISTORIC PATTERN OF GROWTH AND, IN TURN, BUILD GREATER VALUE FOR OUR SHAREHOLDERS

We said in this letter one year ago that the retail environment was undergoing fundamental change. Dramatic shifts in consumer shopping habits and increased competition were significantly altering the landscape in which we operate. During 1995, competition intensified and we saw the beginning of a major industry consolidation. We found that the strategy that served Melville so well in the past no longer enabled us to compete effectively in this new environment.

Recognizing these changes, we undertook a comprehensive strategic review of our corporate structure and the strengths and weaknesses of each of our individual business units. Our goal was to ensure that our businesses are well-positioned to take advantage of the changes taking place and, therefore, to maximize shareholder value.

Capitalizing on Strengths to Enhance Shareholder Value

Following a complete review of our operations, on October 24, 1995, we announced a comprehensive strategic restructuring program that will leverage our strengths. The plan has several primary components:

- the creation of three independent, publicly traded retailing companies based on our core businesses in the chain drug, footwear and toy industries. The chain drug holding company will include CVS and, initially, Linens 'n Things and Bob's Stores. The footwear company will include Meldisco, Footaction and Thom McAn. It should be noted that the footwear segment has been treated as discontinued operations in the financial statements. Kay-Bee Toys will be the toy store company.
- the sale of Marshalls and the planned sales of Wilsons and This End Up.
- a significant reduction in Melville's corporate overhead and consolidation of certain functions of the footwear business units. These combined actions are expected to yield aggregate annual savings of approximately $50 million before taxes.
- the closing of approximately 330 underperforming stores.
- a reduction in the quarterly dividend.

We did not take the decision to pursue this course lightly, for it means enormous change for Melville as we know it today. But we are convinced it is the right course for our shareholders.

There are several important advantages to this plan. First and foremost, it will increase the strategic clarity of each business. Each new company will be focused on a specific industry and will have the decision-making power to respond quickly and decisively to evolving conditions in its industry. With this increased focus, the new companies will be better able to compete and grow in the new retail environment. Their specific strategies are discussed more fully in the sections that follow.

Second, profitability should increase significantly as a result of these actions. We expect to achieve an annual pre-tax profit improvement of approximately $100 million for the three independent companies by 1997. This will result from reducing corporate overhead, consolidating certain functions of the footwear operations, eliminating losses generated by stores that will be closed, lowering interest expense and from the depreciation savings due to the write-off of unproductive assets.

Third, the plan will lead to enhanced financial strength. Proceeds from the sales of Marshalls, Wilsons and This End Up, as well as the reduction in the dividend, and savings from the consolidation of operations will be used to strengthen the balance sheets of the new companies. With enhanced financial resources, these companies will be able to accelerate investment in their businesses, without the need for significant outside financing.

Finally, we believe the financial markets will be able to assign more accurate valuations to each company, since the financial performance of each will be more easily understood.

Stanley P. Goldstein (right)
Chairman and
Chief Executive Officer

Harvey Rosenthal
President and
Chief Operating Officer

Spinoffs and Sales Expected This Summer

We are moving ahead aggressively with the implementation of the plan. This process is proceeding on schedule, and we expect it to be completed this summer. The remaining entity will be the chain drug holding company.

The sale of Marshalls to The TJX Companies was completed in November 1995 for total proceeds of approximately $600 million. We are proceeding with the sales of Wilsons and This End Up and expect to have these completed this summer as well.

We have already made significant progress in reducing corporate overhead and consolidating our footwear operations, and expect to realize cost savings from these actions beginning in the first quarter of 1996. We have reduced headcount and have outsourced certain functions, including real estate and information systems, and have streamlined others.

In addition, as of January 31, we have closed 270 underperforming stores, with the remainder of the 330 to be closed over the course of 1996.

New Dividend Rate Set

In January, the Board of Directors approved a new quarterly dividend rate of $0.11 per share on the Company's common stock, replacing the former rate of $0.38. In line with the restructuring plan, the objectives were to align the payout with the three new companies' growth and capital needs, as well as with prevailing practices in each industry segment. The Board believes this new rate, which is expected to be the dividend rate for the new chain drug holding company, meets these objectives.

Melville's financial results for 1995 reflect the difficult conditions in the industry. In addition, our net earnings were affected by one-time costs associated with the strategic restructuring program. The consolidated net loss, including the after tax charge of $799.0 million, was $657.1 million, or $6.41 per share, as compared to net earnings of $307.5 million, or $2.75 per share, in 1994. Prior to the restructuring and other special charges, consolidated net earnings were $149.8 million, or $1.26 per share. The results do not include Marshalls following its disposition on November 17, 1995. Excluding Marshalls, as well as the restructuring and other special charges in 1995, consolidated net earnings were $1.74 per share in 1995 as compared to $1.83 per share in 1994. Total net sales, including the sales of the discontinued operations for the year, increased 2.0% to a record $11.5 billion.

To Our Shareholders

CVS CONTINUED ITS OUTSTANDING GROWTH, ONCE AGAIN GENERATING RECORD SALES AND OPERATING PROFITS

Adjusting for the disposition of Marshalls, Melville's total net sales, including the sales of discontinued operations, rose 6.7%.

Strong Performances at CVS and Footaction

Despite the decline in our overall results, there were areas of strength in our performance in 1995. CVS continued its outstanding growth, once again generating record sales and operating profits. Footaction had an excellent year, highlighted by a 13.1% gain in same store sales. In addition, we made a number of important operating improvements in several of our businesses, particularly Meldisco and Kay-Bee, which are yielding positive results.

However, the progress we made in these areas was offset by weak performance in others, particularly in the apparel segment. Moreover, the timing of the sale of Marshalls just prior to the Christmas season further impacted the results in this segment.

Board of Directors

We welcomed Thomas P. Gerrity, Dean of The Wharton School of the University of Pennsylvania, to our Board of Directors in 1995. We want to thank all of our Board members for their wise counsel on Melville's restructuring program and for their continued enthusiasm about our Company's future.

Our special thanks go to Donald F. McCullough, who has served as a Director since 1975 and will retire from our Board this spring. We are grateful for his dedicated service over the years and wish him the best in the future.

Positioning Our Businesses to Prosper

As we embark on a new stage in the history of Melville, we would like to take this opportunity to thank the hundreds of thousands of people who have made this enterprise a success over the years. Our associates have dedicated their efforts to this organization, and we are thankful to each and every one of them for their service. We would also like to thank the vendors and landlords who have worked with us. Finally, we would like to thank the millions of customers who have shopped in our stores.

In closing, we are well on our way to completing the objectives of the strategic restructuring program. The changes we have undertaken are formidable. However, it is clearly necessary to take bold and decisive action to position our businesses to prosper in the new retail climate. We believe the restructuring program will enable us to resume our historic pattern of growth and, in turn, build greater value for our shareholders. We look forward to keeping you apprised of our progress and are grateful for your continued support.

Sincerely,

Stanley P. Goldstein
Chairman and
Chief Executive Officer

Harvey Rosenthal
President and
Chief Operating Officer

February 15, 1996

Operating Review

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The Chain Drug Holding Company

CVS: CHAIN DRUG INDUSTRY LEADER WITH OUTSTANDING GROWTH POTENTIAL

CVS: The Leading Drugstore Chain in the Northeast and Middle Atlantic States

CVS offers customers convenience, selection, and superior customer service, as well as comprehensive prescription and pharmacy services. The company is positioned for significant growth well into the 21st century. Fueling this growth is management's clear focus on outperforming the competition in every market and by every measure.

CVS strengthened its leading position in many Northeast and Middle Atlantic markets during 1995, and registered record sales and operating profit. The company focuses on market leadership through convenient locations and store hours, accessible health care services, superior customer service and a wide range of quality products sold through nearly 1,400 stores.

CVS' financial performance was impressive again in 1995. Operating profit before special charges increased 20.1% to $274 million. Total sales jumped 12.4% to $4.9 billion.

Operating profit before special charges as a percent of sales was 5.6%, placing CVS among the top performers in the chain drug industry. Same store sales increased 8.8% as CVS retained its position as the market-share leader in 21 of the 29 markets it serves.

The company's aggressive new store growth program revolves around new market entry, a focus on urban locations, relocation and expansion of existing stores, and strategic acquisitions. In 1996, CVS will enter the Atlanta market, one of the top ten drugstore markets in the country. Management believes this market has the potential for at least 80 new stores. CVS will also open more new stores in urban areas, such as Queens, New York, where stores that were opened in 1995 are performing above expectations. In total, CVS plans to open 95 new stores and relocate approximately 25 existing stores during 1996.

Serving the Managed Care Marketplace

CVS is investing in technology that will enable the company to become a leader in the delivery of comprehensive health care services. RX2000™, the company's state of the art pharmacy computer system, generates one of the largest data warehouses in the country. This data warehouse allows CVS to provide managed care customers with a detailed analysis of the effectiveness of the health care services their members receive.

PharmaCare, CVS' prescription benefit management company, provides comprehensive pharmaceutical services to some of the nation's leading HMOs and managed care providers.

Through its PharmaCare division, CVS participates in the integration of health care delivery systems and has many technological innovations underway to improve service and lower costs. An advanced system called CIMS (Clinical Intervention Management System) allows health plans, physicians and pharmacists to review patient histories. CIMS on-line links

CVS 1995 HIGHLIGHTS

- **Total sales jumped 12.4%.**
- **Operating profit increased 20.1%.***
- **Same store sales rose 8.8%.**

*before special charges

MAXIMUM STRENGTH
TYLENOL
FLU
NightTime
Alka-Seltzer
FAST RELIEF
CVS
MYLANTA
DOUBLE STRENGTH
ANTACID/ANTI-GAS
SOOTHING
VICKS
44D
Cough & Head
Congestion Relief
COLA
GENUINE
BAYER
ASPIRIN
CVS
blue mint
action strips
NEW!
Kodak
35mm film
CHILDREN'S
TYLENOL
CHEWABLE TABLETS
Powerful Medicine
Against Pain
Actron
50 CAPLETS
VICKS
NyQuil
dayhist-d
16 TABLETS
CVS
pharmacy

LINENS 'N THINGS WILL OPEN 35 NEW SUPERSTORES IN 1996

the physician and the pharmacy with PharmaCare to manage formularies when the physician writes a prescription, thus providing more comprehensive clinical information and improving the quality of care delivered. Other components of PharmaCare's comprehensive pharmacy solutions include contract mail order, drug utilization review, real-time data retrieval and claims processing, and full account services.

Information technology is also important in the "front end" of CVS stores, which generates more than half of total sales. Check-out scanning systems are used chain-wide, resulting in improved inventory control, more effective in-stock positions and better markdown management.

An array of technological tools is helping CVS customize its offerings, by market and store, according to the shopping habits of customers. This new automated environment enables CVS to assign management teams responsibility for the success of specific categories of merchandise, such as cosmetics or photofinishing. This category management approach results in distribution efficiencies and a merchandise mix that is targeted to the preference of local consumers.

In the front end of the store, CVS focuses on products and services that make the store a "destination" for customers. The company experienced strong sales growth in greeting cards, photofinishing services, cosmetics, seasonal merchandise, over-the-counter and private label categories. CVS has carefully expanded its private-label portfolio by emphasizing quality and value. The company now offers 1,100 different private-label products, adding snacks and soft drinks in 1995.

CVS is poised for continued significant growth, through entry into new markets and opportunistic acquisitions. Its advanced technology provides the tools to control costs, expand prescription sales, broaden managed-care services and customize merchandise selections. The company's emphasis on convenience, value and service will continue to make CVS an essential shopping destination. A strong pharmacy franchise coupled with PharmaCare's integrated approach to health care delivery will put CVS in the forefront of finding more efficient and effective ways to deliver essential services to individuals and managed care customers.

Linens 'n Things: The Home Furnishings Superstore

Linens 'n Things is a leading national specialty retailer of fashion home textiles and decorative furnishings, offering dominant assortments of name brand merchandise for the bedroom, bathroom, kitchen and dining room.

Linens 'n Things offers excellent potential for growth. Its strategies have focused on expanding its store base in new and existing markets, converting smaller traditional stores to its more productive superstore format, and adding new product lines that complement existing merchandise offerings. The company continues to refine and build the "things" side of its business, which includes home organization, functional housewares, and related seasonal merchandise.

Technology has played an important role in supporting the growth of Linens 'n Things. New systems have significantly improved its ability to gather and analyze data at the store level, leading to more accurate and timely decision-making on merchandising and inventory control. In addition, the company opened a fully automated distribution center to speed deliveries, lower costs, and allow the stores to better focus on customer service.

In 1995, the company opened 29 new superstores, entered five new markets, and remodeled 15 other stores. Targeted expansion will continue in 1996 during which the company will enter seven new markets, opening 35 new superstores. By year end, Linens 'n Things will have a portfolio of 135 superstores and 36 traditional units. All but the most profitable of the traditional stores will eventually be closed.

Sales rose 26.1% to $555 million in 1995. While competition has been fierce in the home textile segment, as in most retail categories, there are signs that impending consolidation will create opportunities for larger players, such as Linens 'n Things. Its strategy is to take advantage of these opportunities to increase market share, and build upon Linens' already strong position.

Bob's: Casual Clothing for the Whole Family- Brand Names, Broad Selection, and Value Pricing

Bob's Stores, "The Original Casual Clothing and Footwear Superstore," operates 34 stores in seven states. Its major product offerings include jeans, sportswear, active apparel, and casual footwear—for men, women and children. Its 40,000-50,000-square-foot formats offer customers a dominant selection of the brands they love to wear at value prices.

Bob's opened 14 new stores in 1995 and now has locations in New York, New Jersey, Connecticut, Massachusetts, Pennsylvania, New Hampshire, and Rhode Island. In 1996, its expansion will largely be focused on adding locations in existing markets to take advantage of advertising and other efficiencies. Bob's will also enter Washington, D.C. in 1996 with its first four stores there. In total, the company plans to open nine new stores in 1996.

Additionally, management will ensure that its merchandising strategy and marketing plans are on target before escalating its growth plans. Bob's Stores in Connecticut, where the business was founded, are among its most productive stores. The company's goal is to build awareness and achieve the same level of success in its newer markets as these stores mature.

A key objective of Bob's during 1995 was to improve its retailing formula to prepare for further expansion. For example, a successful new store design developed in 1994 was further refined during 1995. It makes shopping easier and more fun, with wider aisles, tightly focused display areas and miniature shops. Bob's will continue to focus on making refinements to improve profitability.

The Footwear Company

NEW FOOTWEAR COMPANY WILL BE POSITIONED TO ACHIEVE HIGHER PROFITABILITY

By bringing together its three footwear businesses, Melville is creating a new company positioned to significantly improve operating efficiencies and capitalize on opportunities in the footwear market. The new entity will consist of Meldisco, Footaction and Thom McAn, businesses with complementary focuses and strengths. The integration of these operations provides important advantages, including greater market presence as well as nearly $13 million in annual cost savings that will be achieved by streamlining and consolidating administrative and logistical functions.

The new company will be a leader in both the value-priced and athletic footwear markets. Its management will focus on building upon these positions, as well as pursuing new avenues for growth.

FOOTACTION

1995 HIGHLIGHTS

- **Total sales jumped 27.5%.**
- **Operating profit increased 133.0%.***
- **Same store sales rose 13.1%.**

*before special charges

Footaction: An Essential Stop For Athletic Footwear and Apparel

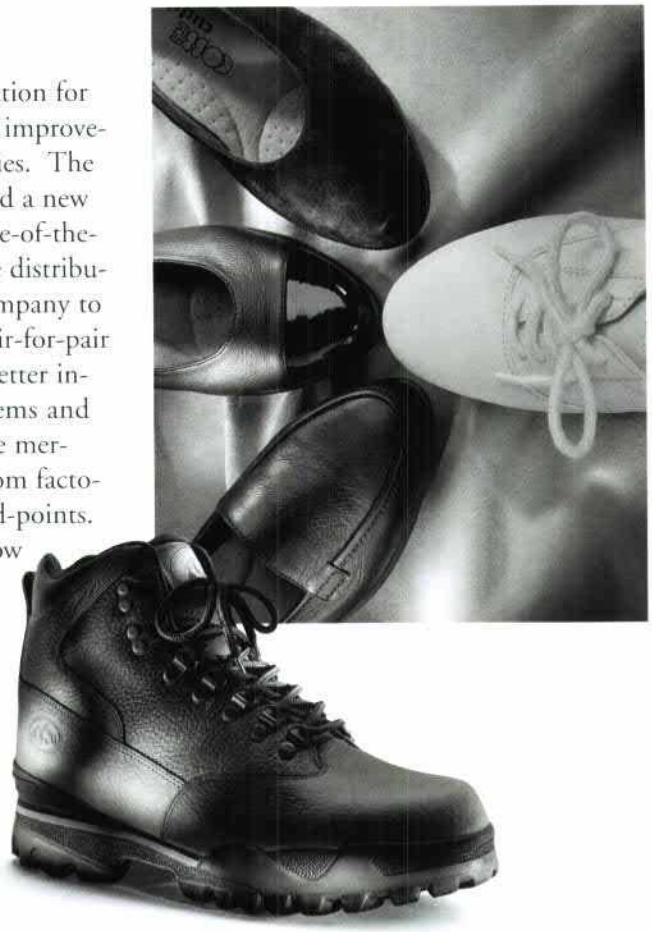
Footaction is one of the leading athletic footwear and apparel specialty chains in the country, operating 439 stores in 43 states and Puerto Rico. Responding to the needs of its customers, the company has developed a distinctive new store prototype. These new stores range in size from 4,000 to 6,500 square feet, with up to half the space devoted to apparel offerings.

Footaction achieved outstanding results in 1995, with operating profit before special charges increasing 133.0%. Same store sales grew an impressive 13.1%. Driven by a successful merchandising strategy, Footaction's results outpaced the growth of the branded athletic footwear category and other competitive athletic footwear specialty retailers. By carrying the most up-to-date merchandise assortment, Footaction has become an essential stop for consumers of athletic footwear and apparel. The chain has a particularly strong following among fashion-conscious youths who rely on Footaction for the latest products from Nike, Reebok, Fila, Adidas and others.

In 1995, Footaction opened 21 new stores, including eight stores acquired in southern New Jersey and Pennsylvania. The company converted 11 additional stores to its new prototype and now has 62 stores presenting its new look. In 1996, Footaction will continue to expand its store base through new store openings, converting existing locations to the new format, and strategic acquisitions.

Meldisco: Improved Operations and Customer Service

Meldisco operates leased footwear departments in 2,178 Kmart stores and 390 Payless Drug stores, providing a full assortment of value-priced footwear for the whole family.



A primary area of concentration for Meldisco during 1995 was the improvement of its operating efficiencies. The company designed and installed a new logistics network with two state-of-the-art distribution centers. These distribution centers will enable the company to replenish merchandise on a pair-for-pair basis, which should result in better in-stock availability of popular items and higher same store sales. Some merchandise is shipped directly from factories to stores, bypassing all mid-points. In addition, the company is now in the process of integrating a leading-edge merchandise replenishment system to further improve efficiency.

The company has also reengineered its store operations to allow associates to spend more time serving customers. By utilizing technology, Meldisco has relieved associates of most administrative responsibilities. In 1995, they were able to spend over 80% of their time serving customers.

Meldisco has also focused on enhancing its merchandise assortments. By leveraging relationships with several key vendors, such as Timberland, Nine West and Hi-Tec, the company has introduced several new strategic brands including Black Ridge Mountain, Cobbie Cuddler, Baywatch and Yosemite by Hi-Tec. In addition, Meldisco continues to develop successful private labels.

To foster growth and enhance profitability in 1996, Meldisco will continue to emphasize technology, logistical improvements and stringent financial controls–all of which are historic company strengths.

Thom McAn: Repositioned For the Working Family

Thom McAn sells stylish, mid-priced, quality shoes for men and women. The company has executed a multi-year restructuring that closed several hundred stores, leaving approximately 315 stores in the Eastern states and Puerto Rico at the end of 1995. The chain was repositioned to offer practical, classical footwear for the working family in a friendly, attractive environment.

Thom McAn's operating margin is expected to improve as its administrative and logistical functions are consolidated in the new footwear company.

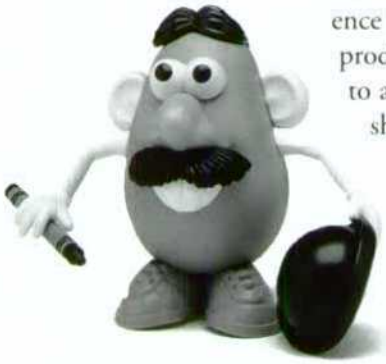
The Toy Store Company

KAY-BEE REMAINS #1 U.S. MALL-BASED TOY CHAIN

Kay-Bee Toy Stores

Kay-Bee Toy Stores is the nation's largest mall-based toy specialty retailer with more than 1,000 stores across the United States and Puerto Rico. The company operates stores under two formats: Kay-Bee Toys, located primarily in shopping malls, and Toy Works, a larger destination store format primarily located in strip shopping centers. Both offer an exciting selection of name brands, hot new toys, popular traditional toys, value-priced and exclusively created toys, and video games.

In 1995, the company unveiled new store designs for both Kay-Bee and Toy Works stores. The new designs have won customer praise for their clean, uncluttered formats and the ease with which merchandise can be found. Kay-Bee has also refined its merchandise selection to take maximum advantage of its mall presence by highlighting value-priced products in prominent locations to attract price-conscious impulse shoppers. In addition, at store front, Kay-Bee demonstrates unique battery-operated light and sound action toys.



During 1995, the company opened 33 new stores and relocated or expanded 20 other stores. Despite a difficult year for all toy retailers, Kay-Bee finished the year with comparable store sales growth of 2.3%. This was accomplished by emphasizing value-priced video games, action figures, dolls, electronic learning toys, radio-controlled vehicles, and stuffed animals. Total sales grew 6.4% in 1995 to $1.1 billion.

In support of merchandise strategies, distribution systems continued to be refined, increasing Kay-Bee's control of its distribution process and ensuring quicker delivery of the most-wanted items. These systems, coupled with more focused training programs, have helped employees serve customers more effectively.

SONY
PlayStation
OPEN
RESET
namco
SONY
PlayStation
SELECT
START
PlayStation
MATURE
M
AGES 17+
SCUS-94201
94201
TEEN
T
AGES 13+
SLUS-00006
00006
Ridge Racer
namco
SCUS-94300
94300
disc

Store Openings and Closings

Number of Stores	1995				1996 (Projected)		
	Beginning	Opened	Closed	Ending	Openings	Closings	Ending
CVS	1,328	73	35	1,366	95	23	1,438
Linens 'n Things	145	29	19	155	35	19	171
Bob's	20	14	-	34	9	-	43
Total Chain Drug Holding Co.	1,493	116	54	1,555	139	42	1,652
Meldisco	2,778	29	239	2,568	32	12	2,588
Footaction	439	21	21	439	39	19	459
Thom McAn	323	22	30	315	1	31	285
Total Footwear Co.	3,540	72	290	3,322	72	62	3,332
Kay-Bee	996	33	25	1,004	16	57	963
Marshalls	484	21	505	-	-	-	-
Wilsons	628	5	85	548	6	84	470
This End Up	237	14	23	228	5	60	173
Total	7,378	261	982	6,657	238	305	6,590

Social Responsibility

In the last few years, Melville has invested its charitable resources—both human and financial—in efforts to strengthen our nation's education system. With this as an overall focus, we have launched a number of philanthropic initiatives that continue to produce exciting results.

One of these initiatives, the Melville Innovations Grants Program, received high marks in 1995 from an independent evaluation. According to the evaluators, Melville "has changed nine schools and the professional staffs who work in them. It has established a model for supporting such change, and it has contributed to thinking about how to engage staff in the difficult task of school reform." Based on this feedback, Melville has launched a new round of Innovations Grants, resulting in four renewal grants and six new grants to schools and districts in Connecticut, New Jersey, New York and Virginia.

In addition to the Innovations Grants supporting individual schools and districts, Melville has helped to launch a statewide school reform effort. Led by a new organization called "The Big Picture Company" and supported by the State of Rhode Island, this initiative will use state-of-the-art technology and human resource development techniques to promote change in schools throughout Rhode Island.

Melville also piloted a new program in 1995 to support schools and organizations where associates are actively volunteering to improve the skills of the future workforce. Called the Melville Challenge Grant Program, eligible associates responded to the "challenge" with great enthusiasm. Selected from a total of 108 applications, 83 Challenge Grants were awarded to projects in 16 states, including 13 grants on behalf of teams of volunteers working together on a project.

Despite the changes that Melville is undergoing, we believe these efforts represent important investments in the future of our schools and communities, and are proud that Melville has maintained its commitment to act as a socially responsible corporate citizen.

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Management's Discussion and Analysis of Financial Condition and Results of Operations

Melville Corporation and Subsidiary Companies

Results of the Strategic Review

In last year's Annual Report the Company announced the initiation of a strategic review, the objective of which was to increase the Company's sales and profits by examining its mix of businesses. This review resulted in the development of a comprehensive strategic program (the "Program") which was announced on October 24, 1995. The primary components of the Program, which management expects to be completed by the summer of 1996, are:

- the creation of three independent, publicly-traded retailing companies in the chain drug, footwear and toy industries;
- a revision of the Company's dividend to align payout ratios with each of the newly created entities' growth and capital needs as well as the prevailing practice in its industry;
- the recording in the fourth quarter of an after-tax charge of $753.1 million ($235.8 million of which related to goodwill) which was comprised of the following components:
  - $434.3 million for the estimated loss on sale of Marshalls, This End Up and Wilsons;
  - $166.8 million for asset write-offs and severance costs associated with the strategic decisions to reposition and integrate certain divisions; to close the corporate headquarters; and to outsource data processing and telecommunications functions;
  - $90.6 million for the early adoption of SFAS No. 121, "Accounting for the Impairment of Long-Lived Fixed Assets and for Long-Lived Assets to be Disposed Of" ("SFAS No. 121"); and
  - $61.4 million for estimated tenancy and severance costs associated with the closure of 330 stores as well as several warehouses.

The Company also changed its accounting policy to expense internally developed software costs that were previously capitalized. After taxes, a charge of $45.9 million was recorded in the first quarter of 1995 in connection with this change.

Creation of Three Independent Companies

Upon completion of the Program, the following three companies will exist, each of which will be adequately capitalized to ensure that they will have the resources to finance their ongoing growth and to excel as free-standing units:

The Chain Drug Holding Company: This company will consist of CVS and, initially, Linens 'n Things and Bob's (as well as various corporate entities). Approximately 85% of this company's revenue will be derived from CVS.

The Footwear Company: This company will be comprised of Meldisco, Footaction and Thom McAn. Pending receipt of a favorable determination that a distribution to shareholders would be tax free, this new company will be spun-off during the summer of 1996. The back office operations of Thom McAn will be integrated into those of Meldisco prior to the spin-off. Meldisco, whose revenues will comprise 65% of the total company, primarily operates leased footwear departments in Kmart discount stores. The Company has sought, and expects to obtain, consent from Kmart to execute this transaction.

The Toy Store Company: Comprised of the Kay-Bee division, it is expected that this entity will be independent by the summer of 1996.

Revised Dividend

On January 10, 1996, the Board of Directors approved a reduction in the quarterly dividend from $0.38 per share to $0.11 per share. Management believes that this rate is consistent with both anticipated capital requirements and industry practice of the Chain Drug Holding Company. No decisions have been made regarding the future dividend policies of the Footwear and Toy Store companies.

Sales of Businesses

The sale of Marshalls was completed on November 17, 1995. The Company is currently negotiating the sales of Wilsons and This End Up. These transactions are anticipated to be completed by the summer of 1996.

Store Closure Program

As of January 31, 1996 the Company has closed approximately 270 stores and expects to close the balance of the designated stores as leases expire throughout 1996.

Impact of the Program on Profitability

As a result of these collective actions, the Company expects that the net cash flow impact of the Program will be positive. Furthermore, among the three independent companies, pre-tax profit improvement of approximately $100 million is expected over the next two years. These savings will be derived principally from reductions in corporate overhead, interest expense and depreciation and amortization expenses due to the write-off of goodwill, impaired assets and internally developed software costs.

Results of Operations

($ in millions, except per share amounts)	1995	1994	1993
Net sales	$9,689.1	$9,445.7	$8,722.3
Same store sales increase	2.2%	3.5%	0.7%
Operating profit before special charges	$ 194.0	$ 450.3	$ 456.0
Restructuring and asset impairment charges	936.8	–	–
Operating (loss) profit	(742.8)	450.3	456.0
Net earnings from continuing operations before special charges and accounting change	48.1	243.6	262.6
Net earnings before special charges and accounting change	100.1	307.5	331.8
Net (loss) earnings	$ (657.1)	$ 307.5	$ 331.8
Earnings per share from continuing operations before special charges and accounting change	0.30	2.15	2.33
Net earnings per share before special charges and accounting change	0.79	2.75	3.00
Net (loss) earnings per share	$ (6.41)	$ 2.75	$ 3.00
Percentage of net sales			
Cost of goods sold, buying and warehousing costs	67.9	66.0	65.6
Selling, general and administrative expenses	28.1	27.3	27.2
Net sales including discontinued operations	$11,516.4	$11,285.6	$10,435.4
Same store sales increase including discontinued operations	1.4%	3.3%	0.1%

Net Sales

Consolidated net sales reported were adjusted to exclude the footwear segment due to the Company's plan to spin it off in 1996. Sales in 1995 also exclude Marshalls after its disposition on November 17, 1995. Adjusting for Marshalls to exclude non-comparable periods, net sales from continuing operations increased 8.2% over 1994, while total company sales, including the footwear segment, increased 6.7%.

CVS, Linens 'n Things, Footaction and Kay-Bee generated positive sales growth throughout 1995, while disappointing performances at Marshalls and Wilsons offset these improvements.

Net sales for the fourth quarter of 1995, which had one more selling day than the fourth quarter of 1994, increased 8.5%, after adjusting for the disposition of Marshalls and the exclusion of the footwear segment.

Net sales for 1994 exclude the results of Chess King, Accessory Lady and Prints Plus, which were sold in 1993. Adjusting for these dispositions, the increase in net sales over 1993 was 9.4% for the year and 4.4% for the fourth quarter. Net sales in 1994 benefitted from strong performances at CVS, Kay-Bee and Linens 'n Things, while lower sales at Wilsons and Thom McAn partially offset these positive results.

Net sales in 1993 were impacted by the three dispositions and the exclusion of stores closed as part of the 1992 strategic realignment program. Adjusting for these factors, sales increased 4.8% over 1992 levels.

Increases in net sales differ from those of same store sales due to store openings, store closings, dispositions and acquisitions. The 1995 same store sales increase was due primarily to very strong performances at CVS and Footaction offset by poor results at Marshalls and Wilsons.

Net Earnings

Net earnings in 1995 were significantly impacted by the restructuring and asset impairment charges ("special charges"), the change in accounting for internally developed software costs and other asset write-offs related to the repositioning of the Company and certain one-time charges. The one-time charges primarily relate to lease settlement costs, severance related costs, markdowns related to discontinued product lines and costs to outsource telecommunications and data processing functions. The lease settlement costs result principally from guarantees of Chess King stores sold to Merry-Go-Round Enterprises, which filed for a Chapter 7 liquidation in January, 1996. Adjusting net earnings to exclude the impact of all of these charges, earnings per share would have been $1.26 as compared to $2.75 in 1994.

Net earnings per share excluding special charges, the effect of the accounting change, one-time costs and asset write-offs declined in 1995, despite an exceptionally strong performance at CVS and significant increases at Linens 'n Things and Kay-Bee, principally due to operating losses at Marshalls and Thom McAn. Excluding Marshalls, as well as the charges noted above, net earnings per share in 1995 would have been $1.74.

In 1994, net earnings were negatively impacted by disappointing performances in the apparel and footwear segments and by a reserve recorded for anticipated lease settlement costs related to guarantees of stores sold to companies which subsequently filed for bankruptcy protection.

Net earnings in 1993 were favorably impacted by $10.0 million due to a change in accounting for LIFO inventories. This was offset by a decline in gross margin at CVS, unfavorable performances in the apparel segment and the recording of a reserve for the loss on sale of a note received for the sale of Chess King.

Melville Corporation and Subsidiary Companies

Costs and Expenses

Cost of goods sold, buying and warehousing costs continue to increase as a percentage of sales, reflecting the increased proportion of the prescription drugs, health and beauty care segment to total operations, compounded by continued pressure on third party providers to offer prescriptions at lower prices. In addition, lower initial markon and increased markdowns in our other segments, particularly in connection with the store closing program and the poor performance of Marshalls, have contributed to the erosion of gross margin.

Selling, general and administrative expenses increased as a percentage of consolidated net sales in 1995 as a result of asset write-offs and one-time costs, as well as from fixed costs which were not adequately leveraged due to sales shortfalls at several divisions and the lost sales volume due to the divestiture of Marshalls before the Christmas selling season. The increase in 1994 resulted from the impact of sales shortfalls while also including lease settlement costs related to guarantees of Chess King and Freddy's stores.

Accounting Changes

The Company early adopted SFAS No. 121 effective October 1, 1995. This statement applies to long-lived assets, identifiable intangibles and goodwill, and specifies that their carrying values must be reviewed for impairment whenever events or changes in circumstances indicate that they may not be recoverable. In such an event, the future cash flows expected from the utilization of the asset must be estimated and, if less than the carrying value of the asset, an impairment loss must be recognized. In connection with the adoption of this statement, the Company recorded a pre-tax charge of $110.4 million (of which $99.6 million related to continuing operations) related to the write-down of fixed and intangible assets.

The Company has changed its policy regarding internally developed software costs, electing to expense all such costs as incurred. The Company believes that this change results in a better matching of revenues and expenses. Accordingly, an after-tax charge of $45.9 million was recorded ($42.0 million of which pertained to continuing operations) to reflect the cumulative effect of this change. The impact on 1995 as a result of this change, exclusive of the cumulative effect, was to reduce net earnings by $4.8 million.

Financial Condition

($ in millions)	1995	1994	1993
Cash and cash equivalents	$ 129.6	$ 117.0	$ 81.0
Cash flows provided by operating activities	345.5	498.4	435.9
Daily average of short-term borrowings	756.1	567.4	464.8
Maximum short-term borrowings	1,196.2	948.5	875.0
Short-term borrowings outstanding at year end	52.0	200.0	90.0
Net interest expense	55.0	32.4	23.8
Ratios			
Long-term obligations to total capitalization	17.8%	12.8%	14.0%
Long-term obligations to shareholders' equity	21.6%	14.7%	16.2%
Current ratio	1.4	1.6	1.8

The Company's primary source of liquidity is cash provided from its operations. The earnings stream of the Company's businesses is skewed heavily to the fourth quarter, when 70% of earnings are normally generated. Consequently, the Company must finance its seasonal inventory needs and capital expenditures through short-term borrowings, primarily commercial paper issuances, at substantially higher levels throughout the year than are reflected on the year-end balance sheets. Year-end borrowing levels were lower in 1995 as compared to 1994 due to the receipt of $375.0 million in cash in connection with the sale of Marshalls on November 17, 1995. Average borrowings were higher in 1995 than in 1994 due to operating losses sustained by Marshalls and Thom McAn and the disappointing performances of several other businesses which generated lower than expected cash flows.

Net interest expense is a function of interest rates and short-term borrowing levels. The increase in net interest expense in 1995 relative to 1994 reflects higher short-term borrowings and higher interest rates, offset by the cash received for Marshalls and lower capital expenditures. Prior to the spin-off of the Footwear Company in 1996, the Company expects to pay to Kmart its undistributed minority interests in net earnings of Meldisco. Such distribution will have no impact on net earnings, but will require a cash outlay of approximately $50.0 million.

Current assets decreased by $90.6 million, due primarily to the sale of Marshalls, offset by the current and deferred tax impact of the special charges and other asset write-offs recorded in 1995, and receivable and investment balances recorded in connection with the disposition. The increase in inventories, excluding the impact of Marshalls, is due to new store openings, opportunistic purchases and increased stock levels required for our larger store formats.

Current liabilities increased due predominantly to restructuring accruals recorded in 1995, offset by lower short term borrowings and the recording of tax refunds receivable as compared to a liability in 1994. Accounts payable increased as a percentage of inventories due to improvements in inventory aging.

CAPITAL EXPENDITURES

($ in millions)	1995	1994	1993
Capital expenditures	$395.0	$421.4	$386.7

Expenditures in all years were principally for improvements to new and existing store locations, store equipment and information systems. Capital expenditures for the continuing companies in 1996 are estimated at $290.0 million, of which $195.0 million pertains to the Chain Drug Holding Company, and are primarily for new store openings, continuing improvements to stores and continued investments in information systems and distribution centers.

PRESCRIPTION DRUGS, HEALTH AND BEAUTY CARE

($ in millions)	1995	1994	1993
Net sales	$4,865.0	$4,330.1	$3,948.2
Operating profit before special charges	273.5	227.7	195.7
Operating profit	252.7	227.7	195.7
Percent change from prior year			
Net sales	12.4	9.7	8.7
Same store sales	8.8	6.0	5.7
Operating profit before special charges	20.1	16.3	(6.2)
Operating profit	11.0	16.3	31.2
Percent of total continuing operations*			
Net sales	50.2	45.8	45.3
Operating profit*	104.2	46.6	41.9

*Before corporate expenses and special charges.

CVS achieved very favorable increases in both net sales and same store sales in 1995 and 1994. Lower margined pharmacy sales increased 16.9% in 1995 and 14.7% in 1994 due to an expansion of the company's managed care business and its ability to capitalize on its dominant market share. Various micro-marketing initiatives, and an expansion of private label merchandise lines, also helped to increase front store sales.

Net sales in 1993 reflect the success of the "Peoples Celebration Event" launched in late May, 1993 to reintroduce these stores to the Washington, D.C. market.

Operating profit before special charges improved in 1995 despite the further growth in pharmacy sales as operating efficiencies and strong same store sales growth facilitated its leveraging of fixed costs.

Operating profit in 1994 increased as 1993 investments in technology yielded lower operating costs and better inventory control, resulting in fewer markdowns.

Special charges in 1995 related principally to the costs of closing stores and several unproductive warehouses as well as asset impairment charges.

APPAREL

($ in millions)	1995	1994	1993
Net sales	$3,055.7	$3,538.9	$3,395.9
Operating (loss) profit before special charges	(72.6)	161.1	181.9
Operating (loss) profit	(672.8)	161.1	181.9
Percent change from prior year			
Net sales	(13.7)	4.2	(2.6)
Same store sales	(7.3)	(1.5)	(3.6)
Operating (loss) profit before special charges	(145.1)	(11.5)	(21.0)
Operating (loss) profit	(517.6)	(11.5)	44.5
Percent of total continuing operations*			
Net sales	31.5	37.5	38.9
Operating profit*	(27.7)	33.0	39.0

*Before corporate expenses and special charges.

The decline in same store sales for this segment was primarily due to the weakness of off-price apparel sales which severely impacted Marshalls as consumer spending continued to shift toward hard lines. Total sales for the segment decreased due to the sale of Marshalls and store closings at Wilsons. Adjusting for the disposition of Marshalls, net sales increased 0.2% over 1994.

Same store sales in 1994 were also impacted by changes in consumer spending, whereby apparel sales slowed at Marshalls while gifts and domestics departments experienced strong increases. The expansion of Bob's contributed to the segment's growth while sales decreased at Wilsons due to unexpectedly warm temperatures in fall and early winter.

The 1993 decrease in net sales was due primarily to the sale of Chess King and Accessory Lady. Adjusting for the divisions sold, net sales in the segment would have increased 2.3% in 1993.

The operating loss in 1995 resulted from the sale of Marshalls prior to the profitable Christmas selling season, as well as higher markdowns throughout the segment during the year and declining same store sales.

Operating profit decreased in 1994 because of lower same store sales and gross margins resulting from the heightened promotional activity throughout the apparel industry. This was partially offset by the exclusion of the unprofitable Chess King division and strong control of variable expenses at both Marshalls and Wilsons.

The special charges recorded in 1995 relate to the estimated loss on sale for Marshalls and Wilsons (including $191.4 million of goodwill), the cost of store closings and asset impairment charges.

Melville Corporation and Subsidiary Companies

TOYS AND HOME FURNISHINGS

($ in millions)	1995	1994	1993
Net sales	$1,768.4	$1,576.7	$1,378.2
Operating profit before special charges	61.7	99.4	89.1
Operating (loss) profit	(115.7)	99.4	89.1
Percent change from prior year			
Net sales	12.2	14.4	(6.5)
Same store sales	1.7	8.3	(2.5)
Operating profit before special charges	(37.9)	11.5	(9.1)
Operating (loss) profit	(216.4)	11.5	2,946.4
Percent of total continuing operations*			
Net sales	18.3	16.7	15.8
Operating profit*	23.5	20.4	19.1

*Before corporate expenses and special charges.

The 1995 increase in net sales for this segment reflects the continued expansion of Linens 'n Things superstores and its product offerings, and a solid performance by Kay-Bee.

Significant increases in net sales were reported at Kay-Bee in 1994 as it enjoyed a strong year in most merchandise categories, and at Linens 'n Things, due to the rollout of its superstore format and increased consumer spending in home furnishings and related products.

Sales in 1993 benefitted from strong performances at Linens 'n Things and This End Up, offset by the disposition of Prints Plus and a decrease at Kay-Bee due to the exclusion from operations of stores designated to be closed under the 1992 strategic realignment program and the lack of a "blockbuster" toy. Adjusting for the stores excluded and sold, net sales in 1993 would have increased 2.6% over 1992.

Operating profit before special charges declined due to startup costs of a new distribution center for Linens 'n Things, higher markdowns to spur sales growth and asset write-offs related to the repositioning of the companies in connection with the Program.

Operating profit improved in 1994 because of very strong sales growth and strict control of variable expenses. In addition, a favorable LIFO adjustment offset the decrease in gross margin caused by the implementation of sharper pricing strategies at Kay-Bee early in the year.

The 1995 special charges provided primarily for costs of store closings, asset impairment charges and outsourcing of data processing functions.

FOOTWEAR (DISCONTINUED OPERATIONS)

($ in millions)	1995	1994	1993
Net sales	$1,827.3	$1,839.9	$1,713.1
Operating profit before special charges	102.0	160.5	167.3
Operating profit	53.5	160.5	167.3
Percent change from prior year			
Net sales	(0.7)	7.4	(6.9)
Same store sales	(2.4)	2.4	(2.5)
Operating profit before special charges	(36.5)	(4.1)	(8.0)
Operating profit	(66.7)	(4.1)	78.4

Despite the very strong growth experienced by Footaction, which posted a 13.1% increase in same store sales, net sales declined in this segment during 1995. This was due to the impact of store closures by Kmart which resulted in a sales shortfall at Meldisco, and a disappointing performance at Thom McAn.

Net sales increases in 1994 at Meldisco and Footaction were offset by a decline at Thom McAn, resulting from the discontinuation of its men's athletic and children's departments in late 1993 as well as a reduction in its store base due to its store closing program.

Net sales decreased in 1993 due to the exclusion from operations of stores designated to be closed under the 1992 strategic realignment program and the discontinuation of product lines. Adjusting for stores excluded at Thom McAn, net sales for the segment would have increased 2.2% in 1993.

Operating profit before special charges declined in 1995 due mostly to an operating loss sustained by Thom McAn as contraction of the chain, coupled with increased markdowns, eroded store contribution levels. Additionally, the decline in contribution from Meldisco, due to the Kmart closings, offset very positive profit growth at Footaction.

Operating profit in 1994 decreased due to weak same store sales at Thom McAn, increased markdowns throughout the segment and higher operating costs incurred from the rapid rollout of Footaction superstores. In addition, about $5.0 million of one-time costs, principally at Meldisco related to Kmart store closings and other contingencies, negatively impacted profits.

The special charges recorded in 1995 provided for the costs of store closings, the consolidation of back office operations of Thom McAn, the outsourcing of data processing functions and asset impairment charges.

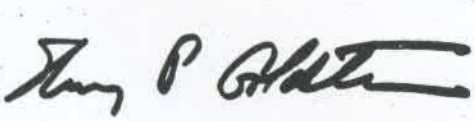
Management's Responsibility For Financial Reporting

The integrity and objectivity of the financial statements and related financial information in this report are the responsibility of the management of the Company. The financial statements have been prepared in conformity with generally accepted accounting principles and include, when necessary, the best estimates and judgments of management.

The Company maintains a system of internal accounting controls designed to provide reasonable assurance, at appropriate cost, that assets are safeguarded, transactions are executed in accordance with management's authorization, and the accounting records provide a reliable basis for the preparation of the financial statements. The system of internal accounting controls is continually reviewed by management and improved and modified as necessary in response to changing business conditions and recommendations of the Company's internal auditors and independent auditors.

The Audit Committee of the Board of Directors, consisting solely of outside directors, meets periodically with management, internal auditors and the independent auditors to review matters relating to the Company's financial reporting, the adequacy of internal accounting controls and the scope and results of audit work. The internal auditors and independent auditors have free access to the Audit Committee.

KPMG Peat Marwick LLP, certified public accountants, are engaged to audit the consolidated financial statements of the Company. Their Independent Auditors' Report, which is based on an audit made in accordance with generally accepted auditing standards, expresses an opinion as to the fair presentation of these financial statements.



Stanley P. Goldstein
Chairman of the Board and
Chief Executive Officer

Carlos E. Alberini
Vice President and Acting
Chief Financial Officer

February 15, 1996

Independent Auditors' Report

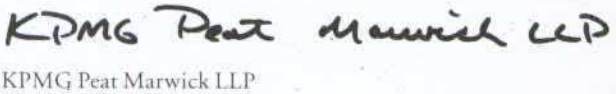
To the Board of Directors and Shareholders of Melville Corporation:

We have audited the accompanying consolidated balance sheets of Melville Corporation and subsidiary companies as of December 31, 1995 and 1994 and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 1995. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Melville Corporation and subsidiary companies at December 31, 1995 and 1994 and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 1995 in conformity with generally accepted accounting principles.

As discussed in notes to consolidated financial statements, the Company has adopted Statement of Financial Accounting Standards No. 121, "Accounting for the Impairment of Long - Lived Assets and for Long - Lived Assets to Be Disposed Of" effective October 1, 1995, changed its policy for accounting for internally developed software costs effective January 1, 1995 and changed its method of determining retail price indices used in the valuation of LIFO inventories in 1993.



KPMG Peat Marwick LLP
New York, New York
February 15, 1996

Consolidated Statements of Operations

Melville Corporation and Subsidiary Companies

(in thousands, except per share data)

Years Ended December 31	1995	1994	1993
Net sales	$9,689,062	$9,445,678	$8,722,308
Cost of goods sold, buying and warehousing costs	6,574,658	6,238,378	5,723,279
	3,114,404	3,207,300	2,999,029
Selling, general and administrative expenses	2,722,621	2,576,680	2,372,362
Depreciation and amortization	197,745	180,356	170,651
Restructuring and asset impairment charges	936,829	–	–
	3,857,195	2,757,036	2,543,013
Operating (loss) profit	(742,791)	450,264	456,016
Interest expense, net	54,977	32,385	23,769
(Loss) earnings from continuing operations before income taxes and cumulative effect of change in accounting principle	(797,768)	417,879	432,247
Income tax (benefit) provision	(182,070)	174,293	169,638
(Loss) earnings from continuing operations before cumulative effect of change in accounting principle	(615,698)	243,586	262,609
Earnings from discontinued operations, net of income taxes of $10,952, $44,448 and $50,803, and minority interests in net earnings of $38,351, $51,895 and $47,296	547	63,884	69,181
(Loss) earnings before cumulative effect of change in accounting principle	(615,151)	307,470	331,790
Cumulative effect of change in accounting principle, net	41,955	–	–
Net (loss) earnings	$ (657,106)	$ 307,470	$ 331,790
Per Share of Common Stock			
(Loss) earnings from continuing operations before cumulative effect of change in accounting principle	$ (6.02)	$ 2.15	$ 2.33
Discontinued operations, net	0.01	0.60	0.67
(Loss) earnings before cumulative effect of change in accounting principle	(6.01)	2.75	3.00
Cumulative effect of change in accounting principle, net	(0.40)	–	–
Net (loss) earnings per share of common stock	$ (6.41)	$ 2.75	$ 3.00
Pro forma net earnings assuming retroactive application of accounting change		$ 291,552	$ 317,232
Per share of common stock		$ 2.60	$ 2.86

See accompanying notes to consolidated financial statements.

Consolidated Balance Sheets

Melville Corporation and Subsidiary Companies

(in thousands except for share amounts and per share data)

As of December 31	1995	1994
Assets		
Current Assets:		
Cash and cash equivalents	$ 129,583	$ 117,035
Investments	175,000	–
Accounts receivable, net	296,393	229,833
Inventories	1,672,957	2,138,243
Prepaid expenses	285,995	165,388
Total Current Assets	2,559,928	2,650,499
Property and equipment, net	1,114,404	1,526,922
Deferred charges and other assets	91,612	109,641
Goodwill, net of accumulated amortization of $28,152 in 1995 and $94,987 in 1994	195,618	448,427
Total Assets	$3,961,562	$4,735,489
Liabilities		
Current Liabilities:		
Accounts payable	$ 690,651	$ 660,691
Accrued expenses	1,039,825	659,502
Notes payable	52,000	200,000
Federal income taxes	–	102,008
Other current liabilities	15,212	20,541
Total Current Liabilities	1,797,688	1,642,742
Long-term debt	327,698	331,340
Deferred income taxes	9,103	81,702
Other long-term liabilities	184,150	188,126
Minority interests in subsidiaries	93,830	108,644
Redeemable Preferred Stock		
Cumulative preferred stock, Series B, $4.00 dividend, par value $100, redeemable at par plus accrued dividends; authorized and issued 17,269 shares in 1995 and 1994; 3,971 shares held in treasury in 1995 and 1994	1,330	1,330
Total Shareholders' Equity	1,547,763	2,381,605
Total Liabilities and Equity	$3,961,562	$4,735,489

See accompanying notes to consolidated financial statements.

Consolidated Statements of Shareholders' Equity

Melville Corporation and Subsidiary Companies

Years ended December 31	1995		1994		1993	
(in thousands, except per share data)	Shares	Amount	Shares	Amount	Shares	Amount
Preference Stock (par value $1.00, authorized 50,000 shares; Series One ESOP Convertible, liquidation value $53.45)						
Outstanding at beginning of year	6,379	$340,948	6,499	$347,346	6,597	$352,583
Conversion to common stock	(112)	(6,001)	(120)	(6,398)	(98)	(5,237)
Outstanding at end of year	6,267	334,947	6,379	340,948	6,499	347,346
Common Stock (par value $1.00, authorized 300,000 shares)						
Issued at beginning of year	111,454	111,454	111,278	111,278	111,150	111,150
Exercise of stock options and awards under stock plans	193	193	173	173	128	128
Conversion of Subordinated Debentures	2	2	3	3	–	–
Issued at end of year	111,649	111,649	111,454	111,454	111,278	111,278
Treasury Stock						
Balance at beginning of year	(5,812)	(283,785)	(5,932)	(289,653)	(6,417)	(313,432)
Reissuance of common stock for business acquired	–	–	–	–	387	18,976
Repurchase of common stock	(843)	(26,310)	–	–	–	–
Conversion of Preference Stock	112	5,504	120	5,868	98	4,803
Balance at end of year	(6,543)	(304,591)	(5,812)	(283,785)	(5,932)	(289,653)
Common stock outstanding at end of year	105,106		105,642		105,346	
Guaranteed ESOP Obligation						
Balance at beginning of year		(328,096)		(328,570)		(335,877)
Reduction of Guaranteed ESOP Obligation		18,421		474		7,307
Balance at end of year		(309,675)		(328,096)		(328,570)
Capital Surplus						
Balance at beginning of year		48,122		42,123		53,302
Reissuance of common stock for business acquired		–		–		(16,459)
Purchase of Series B preferred shares for treasury		–		–		3
Conversion of Preference Stock		497		530		434
Exercise of stock options and awards under stock plans		6,242		5,447		4,843
Conversion of Subordinated Debentures		17		22		–
Balance at end of year		54,878		48,122		42,123
Retained Earnings						
Balance at beginning of year		2,494,383		2,364,322		2,208,875
Net earnings		(657,106)		307,470		331,790
Retained earnings of business acquired		–		–		149
Dividends:						
Preference Stock ($3.90 per share), net		(16,872)		(16,934)		(16,753)
Series B preferred ($4.00 per share)		(53)		(53)		(53)
Common ($1.52 per share)		(159,943)		(160,422)		(159,686)
Balance at end of year		1,660,409		2,494,383		2,364,322
Cumulative Translation Adjustment						
Balance at beginning of year		(1,421)		–		–
Effect of rate fluctuation		1,567		(1,421)		–
Balance at end of year		146		(1,421)		–
Total Shareholders' Equity		$1,547,763		$2,381,605		$2,246,846

See accompanying notes to consolidated financial statements.

Consolidated Statements of Cash Flows

Melville Corporation and Subsidiary Companies

(in thousands)

Years ended December 31	1995	1994	1993
Cash Flows From Operating Activities:			
Net (loss) earnings	$(657,106)	$307,470	$331,790
Adjustments to reconcile net (loss) earnings to net cash provided by operating activities:			
Restructuring and asset impairment charges	982,447	–	–
Cumulative effect of change in accounting principle	74,489	–	–
Depreciation and amortization	228,352	206,266	191,588
Minority interests in net earnings	38,351	51,895	47,296
Deferred income taxes and other noncash items	(204,841)	1,993	15,595
Change in assets and liabilities, excluding acquisitions and dispositions:			
(Increase) decrease in accounts receivable, net	(29,996)	(15,013)	33,484
Increase in inventories	(214,343)	(266,069)	(86,344)
Increase in prepaid expenses, deferred charges and other assets	(21,454)	(14,123)	(14,392)
Increase (decrease) in accounts payable and accrued expenses	225,462	125,849	(125,150)
(Decrease) increase in Federal income taxes payable and other liabilities	(75,899)	100,093	42,016
Net Cash Provided by Operating Activities	345,462	498,361	435,883
Cash Flows From Investing Activities:			
Additions to property and equipment	(394,951)	(421,375)	(386,724)
Proceeds from the sale or disposal of property and equipment and operations or assets sold	423,598	86,899	97,940
Acquisitions, net of cash	(4,809)	(36,556)	(41,534)
Net Cash Provided by (Used in) Investing Activities	23,838	(371,032)	(330,318)
Cash Flows From Financing Activities:			
Dividends paid or payable	(239,985)	(225,500)	(245,635)
(Reductions of) additions to notes payable	(148,000)	110,000	90,000
Increase (decrease) in book overdrafts	65,775	26,931	(6,701)
Repurchase of common stock	(26,310)	–	–
Reductions of long-term debt and obligations under capital leases	(10,518)	(4,423)	(13,190)
Other	2,286	1,727	5,794
Net Cash Used in Financing Activities	(356,752)	(91,265)	(169,732)
Net increase (decrease) in cash and cash equivalents	12,548	36,064	(64,167)
Cash and cash equivalents at beginning of year	117,035	80,971	145,138
Cash and Cash Equivalents at End of Year	$129,583	$117,035	$ 80,971

See accompanying notes to consolidated financial statements.

Notes to Consolidated Financial Statements

Melville Corporation and Subsidiary Companies

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation: The consolidated financial statements include the accounts of all subsidiary companies. The minority interests principally represent the 49% participation of Kmart Corporation in the ownership of all retail subsidiaries formed or to be formed from July, 1967 until July 1, 2012 for the purpose of operating leased shoe departments in Kmart stores. All intercompany balances and transactions have been eliminated.

Basis of Presentation: The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents: Cash equivalents consist of highly liquid instruments with maturities of three months or less and are stated at cost which approximates market. The Company's cash management program utilizes zero balance accounts. Accordingly, all book overdraft balances have been reclassified to current liabilities.

Investments: Investments consist of available-for-sale securities whose carrying values approximate fair market value.

Inventories: Inventories are stated at the lower of cost or market. Inventories of the retail operations are determined primarily by the retail method with 12.8% valued on a last-in, first-out ("LIFO") basis. Inventories of the manufacturing operations are determined on a first-in, first-out ("FIFO") basis.

Fixed Assets: Depreciation and amortization of property and equipment is computed on a straight-line basis, generally over the estimated useful lives of the assets or, when applicable, the life of the lease, whichever is shorter. Amortization of leased property under capital leases is computed on a straight-line basis over the life of the lease. Capitalized software costs are amortized on a straight-line basis over their estimated useful lives.

Impairment of Long - Lived Assets: When changes in circumstances warrant measurement, impairment losses for store fixed assets are calculated by comparing projected store cash flows over the lease term to the asset carrying values.

Deferred Charges: Deferred charges, principally beneficial leasehold costs, are amortized on a straight-line basis, generally over the remaining life of the leasehold acquired.

Goodwill: The excess of acquisition cost over the fair value of net assets acquired is amortized on a straight-line basis over periods not to exceed forty years. Impairment is assessed based on profitability of the related business relative to planned levels.

Maintenance and Repairs: Maintenance and repairs are charged directly to expense as incurred. Major renewals or replacements are capitalized after making necessary adjustments in the asset and accumulated depreciation accounts for the items renewed or replaced.

Store Opening and Closing Costs: New store opening costs are charged to expense as incurred. In the event a store is closed before its lease has expired, the total lease obligation, less sublease rental income, is provided for in the year of closing.

Advertising Costs: The Company charges production costs of advertising to expense the first time the advertising takes place.

Interest Expense: Interest costs charged to discontinued operations includes only third party interest and excludes interest related to intercompany balances.

Federal Income Taxes: The Company and its wholly-owned subsidiaries file a consolidated Federal income tax return. The tax benefit for dividends on unallocated shares of Series One Convertible ESOP Preference Stock ("ESOP Preference Stock") is recorded as a credit to retained earnings.

Accounting Changes: Effective January 1, 1995, the Company changed its policy from capitalizing internally developed software costs to expensing them as incurred.

Effective October 1, 1995, the Company adopted Statement of Financial Accounting Standards ("SFAS") No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of".

Effective January 1, 1994, the Company adopted SFAS No. 112, "Employers' Accounting for Postemployment Benefits", the cumulative effect of which was not material to the consolidated financial statements and is therefore not presented separately.

Effective January 1, 1993, the Company adopted SFAS No. 109, "Accounting for Income Taxes" ("SFAS No. 109"), the cumulative effect of which was also immaterial to the consolidated financial statements and is therefore not presented separately.

In 1993, the Company changed its method of determining retail price indices used in the valuation of LIFO inventories.

Postretirement Benefits: The annual cost of postretirement benefits is funded as they arise and the cost is recognized over an employee's term of service with the Company.

Earnings Per Share: Primary earnings per share is computed by dividing net earnings, after deducting net preferred dividends on redeemable preferred stock and the ESOP Preference Stock, by the weighted average number of common shares outstanding during the year.

Fully diluted earnings per share is computed based upon the assumed conversion of the ESOP Preference Stock into common stock. Net earnings are reduced by the difference between the current dividend on the ESOP Preference Stock and the common stock, adjusted for certain nondiscretionary expenses based on net earnings.

Foreign Currency Translation: The Company translates foreign currency financial statements by translating balance sheet accounts at the year-end exchange rate and income statement accounts at the average rate for the year. Translation gains and losses are recorded in shareholders' equity, and realized gains and losses are reflected in income. The

balance in the cumulative translation adjustment account relates principally to the Company's operations in Mexico. Transaction gains and losses were immaterial.

Reclassifications: Certain reclassifications have been made to the consolidated financial statements of prior years to conform to the 1995 presentation.

Restructuring and Asset Impairment Charges

On October 24, 1995, the Company announced a comprehensive restructuring plan comprising the spin-off of the Company's footwear and toy retailing businesses, the sale of the Marshalls, Wilsons and This End Up subsidiaries, the outsourcing of certain information processing and telecommunications functions, the closure of approximately 330 stores and the streamlining of the corporate overhead structure. In connection with the initiation of the plan, a pre-tax charge of $872.0 million was recorded (of which $837.2 related to continuing operations). Asset writeoffs included in the charge totaled $659.7 million, while the balance will require cash outlays, primarily in 1996. In connection with the various components of the plan, positions for approximately 1,200 store employees and 400 administrative employees have been or will be eliminated.

The significant components of the restructuring charge, and the reserves remaining as of December 31, 1995, were as follows:

($ in thousands)	Recorded	Remaining
Loss on sale of subsidiaries	$587.1	$204.9
Lease obligations and asset writeoffs for store closings, office closings and abandonment of warehouse facilities	146.7	80.3
Contract termination costs and asset writeoffs related to outsourcing	64.3	24.0
Severance and employee benefit vesting	48.0	47.8
Exit costs associated with the consolidation of footwear operations	20.0	19.6
Other	5.9	–
	$872.0	$376.6

Operations impacted by the plan accounted for 50.6% of 1995 sales and 15.5% of 1995 operating profit from all operations before special charges. These operations (including those classified as discontinued operations) accounted for 33.3% of total assets and 26.8% of total liabilities as of December 31, 1995.

Effective October 1, 1995, the Company adopted SFAS No. 121 and recorded a pre-tax asset impairment charge of $110.4 million (of which $99.6 million related to continuing operations) related to the write-down of fixed and intangible assets.

Total goodwill written off within the special charges was $239.7 million.

On November 17, 1995, the Company completed the sale of its Marshalls subsidiary to The TJX Companies, Inc. ("TJX") for approximately $600.0 million, consisting of $375.0 million in cash, and $175.0 million of TJX preferred stock, with the balance to be paid in cash during the first quarter of 1996. This transaction resulted in a pre-tax loss of $245.0 million, which is included in the total restructuring charge recorded by the Company.

Discontinued Operations

As part of its comprehensive restructuring program, the Company intends to spin-off its footwear segment to shareholders during 1996. Accordingly, the results of operations for these businesses have been classified as discontinued operations for all periods presented in the consolidated statements of operations.

Discontinued operations accounted for 16.4% of total assets and 14.4% of total liabilities as of December 31, 1995. The following table summarizes the financial results of the discontinued operations for the years ended December 31:

($ in millions)	1995	1994	1993
Net sales	$1,827.3	$1,839.9	$1,713.1
Operating profit	53.5	160.5	167.3

Operating profit for 1995 reflects $34.8 million of restructuring charges related to the consolidation of operations and the closure of stores, as well as an asset impairment charge of $10.8 million related to the adoption of SFAS No. 121.

Investments

In connection with the sale of Marshalls to TJX, the Company received 250,000 shares of TJX Series D Convertible Preferred Stock ("Series D Stock"), valued at $25.0 million and 1,500,000 shares of TJX Series E Convertible Preferred Stock ("Series E Stock"), valued at $150.0 million. The Series D stock earns cash dividends at an annual rate of 1.814% and is automatically convertible in one year to between 1,343,988 and 2,024,291 shares of TJX common stock, depending upon the price of TJX common stock. The Series E stock earns cash dividends at an annual rate of 7.0% and is automatically convertible in three years to between 8,093,927 and 9,716,599 shares of TJX common stock, depending upon the price of TJX common stock on the conversion date.

Upon request of the Company, TJX must register the Series E stock unless such registration would interfere with any material transaction or securities underwriting. On December 8, 1995, the Company requested registration of these shares. Due to the automatic conversion of the Series D stock during 1996, and the Company's intention to sell the Series E stock during 1996, the securities have been classified as current assets in the accompanying consolidated balance sheet.

Melville Corporation and Subsidiary Companies

Accounts Receivable

Accounts receivable at December 31 consisted of the following:

($ in thousands)	1995	1994
Trade accounts	$ 159,504	$ 170,296
Federal income tax refund	22,432	–
Other	147,895	78,395
	329,831	248,691
Less allowance for doubtful accounts	33,438	18,858
	$ 296,393	$ 229,833

Inventories

Inventories at December 31 consisted of the following:

($ in thousands)	1995	1994
Finished goods	$ 1,661,677	$ 2,131,041
Work-in-process	767	645
Raw materials and supplies	10,513	6,557
	$ 1,672,957	$ 2,138,243

Prior to 1993, the Company used the U.S. Bureau of Labor Statistics indices to measure inflation or deflation in the valuation of its LIFO inventories. In 1993, internally developed indices were used to more accurately measure price fluctuations. The net earnings impact of this change on prior years, individually and cumulatively, is not determinable. The change increased 1993 net earnings by $10.0 million.

Had the FIFO method been used, the carrying value of inventories valued on a LIFO basis would have increased by $4.6 million and $8.1 million at December 31, 1995 and 1994, respectively.

Prepaid Expenses

Prepaid expenses at December 31 consisted of the following:

($ in thousands)	1995	1994
Deferred income taxes	$ 228,072	$ 97,668
Other	57,923	67,720
	$ 285,995	$ 165,388

Property and Equipment

Property and equipment at December 31 consisted of the following:

($ in thousands)	1995	1994
Land	$ 56,683	$ 32,917
Buildings and improvements	244,273	222,939
Fixtures and equipment	910,101	1,246,682
Leasehold improvements	483,289	687,095
Capitalized leases	13,581	42,208
	1,707,927	2,231,841
Accumulated depreciation and amortization	593,523	704,919
	$ 1,114,404	$ 1,526,922

Effective January 1, 1995 the Company changed its policy to expense internally developed software costs as incurred. The accounting change resulted in an after-tax charge of $45.9 million in 1995, including discontinued operations. The effect on earnings, had the new policy been in effect, would have been to reduce net earnings by $15.9 million and $14.6 million in 1994 and 1993, respectively.

Accrued Expenses

Accrued expenses at December 31 consisted of the following:

($ in thousands)	1995	1994
Restructuring accrual	$ 296,874	$ –
Taxes other than Federal income taxes	120,959	143,801
Salaries and wages	100,649	63,910
Rent	78,064	87,811
Other	443,279	363,980
	$1,039,825	$ 659,502

Short-Term Borrowing Arrangements

Information regarding short-term borrowings outstanding at December 31 was as follows:

($ in millions)	1995	1994
Commercial paper	$ 52.0	$ 200.0
Weighted average interest rate	5.9%	6.0%
Lines of credit available	$1,148.0	$ 693.5
Letters of credit outstanding	331.4	433.9

The Company has available lines of credit with various banks which permit borrowings at prime or other negotiated interest rates. There were no short-term borrowings outstanding under these lines of credit at December 31, 1995 and 1994.

The Company can also obtain short-term financing through the issuance of commercial paper and bank loan participation notes, and is not obligated under any formal or informal compensating balance agreements.

Long-Term Debt

Long-term debt at December 31 consisted of the following:

($ in thousands)	1995	1994
Guaranteed ESOP note, 8.52%, payable in various installments through 2008*	$ 323,000	$ 340,100
Other notes and mortgages payable	19,047	8,637
	342,047	348,737
Less current installments	14,349	17,397
	$ 327,698	$ 331,340

*See Employee Stock Ownership Plan footnote.

The aggregate long-term debt maturing during each of the next five years is as follows: $14.3 million in 1996, $18.1 million in 1997, $21.8 million in 1998, $13.9 million in 1999 and $16.6 million in 2000.

Net interest expense for the years ended December 31 included the following:

($ in thousands)	1995	1994	1993
Interest expense*	$55,334	$33,453	$25,586
Interest income and capitalized interest	357	1,068	1,817
Net interest expense	$54,977	$32,385	$23,769

* Excludes interest related to the guaranteed ESOP note but includes interest costs recognized in connection with the Company's contribution to the ESOP.

Leases

The Company and its subsidiaries lease retail stores and warehouse and office facilities over periods generally ranging from 5 to 25 years with options to renew such terms ranging from 5 to 15 years.

At December 31, 1995, the future minimum lease payments under capital leases, rental payments required under operating leases, and future minimum sublease rentals excluding lease obligations for closed facilities were as follows:

($ in thousands)	Capital Leases	Operating Leases
1996	$ 1,700	$ 398,442
1997	1,354	373,913
1998	1,374	344,348
1999	1,336	312,899
2000	843	280,352
Thereafter	7,158	1,479,356
Total	$13,765	$3,189,310
Less amount representing interest	5,945	
Present value of minimum lease payments	$ 7,820	
Total future minimum sublease rentals	$ 454	$ 29,030

Net rental expense for all operating leases for the years ended December 31 was as follows:

($ in thousands)	1995	1994	1993
Minimum rentals	$485,988	$442,179	$417,201
Contingent rentals based on sales	30,640	30,229	28,897
	516,628	472,408	446,098
Less sublease rentals	12,423	9,529	6,068
	$504,205	$462,879	$440,030

Contingencies

In connection with certain dispositions completed between 1991 and 1995, Melville Realty Company, Inc. ("MRC"), a wholly owned subsidiary of the Company, continued to guarantee rental and other lease-related charges for 474 retail stores. The present value of these minimum rental payments at December 31, 1995 was approximately $590.6 million. This amount does not include leases related to the sale of Chess King to Merry-Go-Round Enterprises ("MGRE"), which plans to liquidate in accordance with Chapter 7 of the United States Bankruptcy Code. Pursuant to the terms of sale to a third party of a note receivable from MGRE, the Company will be indemnified for 52.5% of costs incurred under any guarantees for Chess King stores. As of December 31, 1995, there are 250 leases guaranteed by MRC which have been rejected as part of the liquidation and have not yet been settled. The Company has accrued its unindemnified portion of the lease liability.

The Company is also a defendant in various lawsuits arising in the ordinary course of business. In the opinion of management and its outside counsel, the ultimate disposition of all lawsuits will not have a material adverse effect on the Company's consolidated financial position.

Stock Incentive Plans

The Company's 1990 Omnibus Stock Incentive Plan (the "Plan"), as amended, provides for the granting of options, restricted stock and other stock-based awards for a maximum of 8,000,000 shares of common stock to key employees. The Plan replaced the Company's 1973 and 1987 Stock Option Plans and the 1980 Restricted Stock Plan ("Previous Plans").

Stock options under the Plan are awarded at the fair market value on the date of grant. The right to exercise these options generally commences between one and three years from the date of grant and expires ten years after the grant date, provided the optionee continues to be employed by the Company.

The 1989 Directors' Stock Option Plan ("Directors' Plan") for non-employee directors ("eligible directors") provides for the granting of options to purchase a maximum of 150,000 shares of common stock. Any person who becomes an eligible director receives an initial option grant to purchase 2,000 shares of common stock, and, on each January 11 after such initial grant through January 11, 1998, is automatically granted an additional option to purchase 1,000 shares. All options are awarded at the fair value on the date of grant.

The right to exercise options granted under the Directors' Plan generally commences six months from the date of grant and expires ten years after the grant date, provided the director has served continuously during the exercise period.

Information with respect to stock option activity under the Plan, the Previous Plans and the Directors' Plan is as follows:

	Number of Shares	Option Price Range Per Share
Outstanding at December 31, 1992	3,027,225	$ 18.19 / $ 54.75
Granted	709,650	41.13 / 53.50
Exercised	126,400	18.19 / 52.00
Cancelled	139,875	39.38 / 52.00
Outstanding at December 31, 1993	3,470,600	$ 18.19 / $ 54.75
Granted	201,000	30.25 / 41.00
Exercised	76,428	18.19 / 39.38
Cancelled	7,000	45.00
Outstanding at December 31, 1994	3,588,172	$ 26.72 / $ 54.75
Granted	3,047,725	31.25 / 37.38
Exercised	17,400	28.69 / 36.00
Cancelled	23,800	37.38
Outstanding at December 31, 1995	6,594,697	$ 26.72 / $ 54.75
Exercisable at December 31, 1995	3,557,305	$ 26.72 / $ 54.75

Of the options outstanding at December 31, 1995, approximately 4.3 million are held by employees of operations to be sold or spun-off, or by employees to be terminated under the Company's restructuring plan. Such employees will be entitled to exercise their options for a 90 day period following termination.

The Plan also permits the granting of performance shares, representing rights to receive cash and/or common stock of the Company based upon certain performance criteria over a three-year performance period, and performance based restricted shares, representing rights to receive common stock of the Company based upon certain performance criteria over a one-year performance period. Compensation expense related to grants under these provisions is based on current market price of the Company's common stock and the extent to which performance criteria are being met.

Information regarding performance shares and performance based restricted shares is as follows:

($ in millions)	1995	1994	1993
Units awarded	32,297	77,376	54,301
Fair market value of units awarded	$ 1.2	$ 2.9	$ 2.6
Shares granted related to units previously awarded	60,807	42,051	–
Fair market value of shares granted	$ 2.2	$ 1.6	$ –

Restricted stock awards are currently granted under the Plan only in connection with the hiring or retention of key executives and are subject to certain conditions. Restrictions are lifted generally three or four years after the grant date, provided the executive continues to be employed by the Company. Information with respect to the restricted shares is as follows:

($ in millions)	1995	1994	1993
Shares granted	112,773	55,050	2,225
Fair market value of shares granted	$ 4.1	$ 1.9	$ 0.1
Shares cancelled	11,452	1,535	420

At December 31, 1995 shares available for grant under the Plan totaled 1,901,254 and 57,000 shares of stock were available for grant under the Directors' Plan.

Treasury Stock

In connection with the management of the Company's stock incentive plans, the Company reacquired 842,900 shares of common stock during 1995 at a cost of $26.3 million. No shares were reacquired during 1994 or 1993.

Redeemable Preferred Stock

The Company is required to provide $279,000 annually, on December 1, as a sinking fund to repurchase shares of Series B preferred stock at prices not to exceed $100 per share. Any balance not so applied within one year is returned to the general funds of the Company. The difference between the cost of shares repurchased and par value is reflected in capital surplus.

Postretirement Benefits

The Company provides postretirement health benefits at several divisions for retirees who meet certain eligibility requirements.

The weighted average discount rate used to determine the accumulated postretirement benefit obligation ("APBO") was 6.89% and 8.67% at December 31, 1995 and 1994, respectively. The following table reflects the accrued postretirement benefit cost as of December 31:

($ in thousands)	1995	1994
Retirees	$ 16,625	$ 14,335
Fully eligible active plan participants	1,439	1,987
Other active plan participants	10,709	8,078
APBO	28,773	24,400
Unrecognized prior service gain	13,130	14,163
Unrecognized net gain	7,955	6,817
Accrued Postretirement Benefit Cost	$ 49,858	$ 45,380

Effective December, 1992, the Company amended these plans to terminate certain benefits, resulting in a prior service gain of $16.7 million to be amortized over 13 years. The net periodic cost recorded for the years ended December 31 was as follows:

($ in thousands)	1995	1994	1993
Interest expense	$2,000	$2,000	$2,200
Service cost	(900)*	(500)*	(1,000)*
	$1,100	$1,500	$1,200

* Net of prior service gain amortization.

For measurement purposes, a 10.0% increase in the cost of covered health-care benefits was assumed for 1995; the rate was assumed to decline gradually to 5.0% in 2005, and remain at that level thereafter. A 1.0% increase in the health-care cost trend rate would increase the APBO at December 31, 1995 by $3.5 million, and the 1995 annual expense by $0.4 million.

401(k) Profit Sharing Plan

The Company has a qualified 401(k) Profit Sharing Plan available to full-time employees who meet the plan's eligibility requirements. This plan, which is also a defined contribution plan, contains a profit sharing component, with tax-deferred contributions to each employee based on certain performance criteria, and also permits employees to make contributions up to the maximum limits allowed by Internal Revenue Code Section 401(k). Under the 401(k) component, the Company matches a portion of the employee's contribution under a predetermined formula based on the level of contribution and years of vesting service. Company contributions to the plan for both profit sharing and matching of employee contributions, including discontinued operations, were $21.7 million, $18.0 million and $20.3 million in 1995, 1994 and 1993 respectively.

Employee Stock Ownership Plan

The Company sponsors a defined contribution plan for all full-time employees through its Employee Stock Ownership Plan ("ESOP").

The ESOP Trust (the "Trust") borrowed $357.5 million through a 20-year loan guaranteed by the Company and used the proceeds to purchase 6,688,494 shares of ESOP Preference Stock from the Company. The original liquidation value of the ESOP Preference Stock is guaranteed by the Company. Dividends are cumulative at the stated rate or the common stock rate if higher.

Information regarding the ESOP is as follows:

($ in millions)	1995	1994	1993
Dividends paid	$49.2	$ –	$29.6
Dividends accrued	–	24.9	–
Annualized dividends	24.3	24.9	25.3
Tax benefit of annualized dividends	9.8	10.0	10.1
Cash contributions (1)	14.2	11.1	7.9
Interest costs incurred by the Trust	28.4	29.0	29.5
Compensation expense recognized (2)	6.2	5.9	5.7
Interest expense recognized (2)	6.4	5.3	5.9

(1) 1994 amount accrued; paid January, 1995.
(2) Including discontinued operations.

Contributions to the ESOP, plus the dividends paid on the ESOP Preference Stock held by the Trust, are used to repay the loan principal and interest. The difference between the cash contribution and the aggregate expense recognized is credited to the Guaranteed ESOP Obligation. In connection with the Company's restructuring plan, approximately one million shares of ESOP Preference Stock will be converted to common shares in 1996. Based on the market price of the Company's common stock on December 31,1995, such conversions will result in an expense of $23.0 million, which was provided as part of the 1995 restructuring charge.

Income Taxes

Effective January 1, 1993, the Company adopted SFAS No. 109. The cumulative effect of this accounting change was not material.

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's deferred tax assets and liabilities as of December 31 were as follows:

($ in thousands)	1995	1994
Deferred tax assets:		
Property and equipment	$112,479	$ –
Employee benefits	75,944	66,233
Inventories	22,715	33,956
Other assets	7,831	7,895
Total deferred tax assets	218,969	108,084
Deferred tax liabilities:		
Property and equipment	–	92,118
Net deferred tax assets	$218,969	$ 15,966

Based on historical pre-tax earnings, the Company believes it is more likely than not that the net deferred tax assets will be realized.

The income tax (benefit) provision for the years ended December 31 consisted of the following:

($ in millions)	1995	1994	1993
Federal	$(187.3)	$130.0	$129.9
State	5.2	44.3	39.7
	$(182.1)	$174.3	$169.6

The income tax (benefit) provision includes a net deferred tax benefit of $189.6 million in 1995 and net deferred tax charges of $28.5 million and $82.3 million in 1994 and 1993.

Reconciliations of the effective tax rates to the U.S. statutory income tax rates are as follows:

Percent of pre-tax income	1995	1994	1993
Effective tax rate	22.8	41.7	39.2
State income taxes, net of Federal tax benefit	0.4	(6.9)	(6.0)
Goodwill	11.8	(1.0)	(0.9)
Other	–	1.2	2.7
Statutory income tax rates	35.0	35.0	35.0

SUPPLEMENTAL CASH FLOW INFORMATION

During the years ended December 31, the Company had the following non-cash financing and investing activities:

($ in thousands)	1995	1994	1993
Fair value of assets acquired	$ 4,809	$41,832	$61,144
Cash paid	4,809	36,578	38,814
Liabilities assumed	$ –	$ 5,254	$22,330
Stock or note received for operations sold	$175,000	$ –	$29,413
Book value of common stock issued in pooling of interests	–	–	18,976

Cash payments for income taxes and interest for the years ended December 31 were as follows:

($ in thousands)	1995	1994	1993
Income taxes	$162,888	$140,789	$157,240
Interest (net of amounts capitalized)	55,500	34,113	25,747

RECENT ACCOUNTING PRONOUNCEMENTS

On October 23, 1995, the Financial Accounting Standards Board issued SFAS No. 123, "Accounting for Stock-Based Compensation" ("SFAS No. 123"). The provisions of this statement are effective for fiscal years beginning after December 15, 1995.

As permitted under SFAS No. 123, the Company has elected not to adopt the fair value based method of accounting for its stock-based compensation plans, but will continue to account for such compensation under the provisions of APB Opinion No. 25. The Company will comply with the disclosure requirements of SFAS No. 123 in 1996.

Summary of Quarterly Results (1)

(Unaudited; $ in thousands, except per share data)

	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
Net Sales				
1995	$2,124,714	$2,292,165	$2,351,216	$2,920,967
1994	1,999,682	2,063,974	2,246,312	3,135,710
Gross Margin				
1995	$ 655,057	$ 738,436	$ 741,775	$ 979,136
1994	647,415	695,049	749,790	1,115,046
(Loss) Earnings from Continuing Operations before Cumulative Effect of Change in Accounting Principle				
1995	$ (23,330)	$ 13,792	$ (18,990)	$ (587,170)
1994	(1,665)	29,526	35,278	180,447
Net (Loss) Earnings before Cumulative Effect of Change in Accounting Principle				
1995	$ (30,354)	$ 30,665	$ (5,104)	$ (610,358)
1994	(2,505)	45,602	51,718	212,655
Net (Loss) Earnings				
1995	$ (72,309)	$ 30,665	$ (5,104)	$ (610,358)
1994	(2,505)	45,602	51,718	212,655
(Loss) Earnings Per Share from Continuing Operations before Cumulative Effect of Change in Accounting Principle				
1995 Primary	$ (0.26)	$ 0.09	$ (0.22)	$ (5.63)
1994 Primary	(0.06)	0.24	0.29	1.67
1994 Fully Diluted (2)	(0.06)	0.24	0.29	1.62
(Loss) Earnings Per Share before Cumulative Effect of Change in Accounting Principle				
1995 Primary	$ (0.33)	$ 0.25	$ (0.09)	$ (5.85)
1994 Primary	(0.06)	0.39	0.45	1.97
1994 Fully Diluted (2)	(0.06)	0.39	0.45	1.90
Net (Loss) Earnings Per Share				
1995 Primary	$ (0.73)	$ 0.25	$ (0.09)	$ (5.85)
1994 Primary	(0.06)	0.39	0.45	1.97
1994 Fully Diluted (2)	(0.06)	0.39	0.45	1.90

(1) Results of all quarters prior to fourth quarter 1995 have been restated to segregate the results of discontinued operations. 1995 quarters have also been restated to reflect the retroactive effect of the change in accounting principle.

(2) Dilutive effect in the fourth quarter due to the assumed conversion of the ESOP Preference Stock and the seasonality of earnings.

Market Information

Melville Corporation's common stock is listed on the New York Stock Exchange. Its trading symbol is MES. Information with respect to quarterly trading ranges (based on low/high stock prices), dividends paid per share and number of shareholders is as follows:

	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	Year
Market Price Per Share					
1995	$30⅜-37½	$33⅝-39⅞	$32¾-37¼	$28⅜-37¼	$28⅜-39⅞
1994	35⅝-41⅞	37⅛-41⅞	34½-39⅞	29⅝-36⅜	29⅝-41⅞
Dividends Paid Per Share					
1995	$ 0.38	$ 0.38	$ 0.38	$ 0.38	$ 1.52
1994	0.38	0.38	0.38	0.38	1.52
Number of Common Shareholders					
1995					6,500
1994					7,200

Melville Corporation and Subsidiary Companies

SEGMENT INFORMATION

The Company is a specialty retailer conducting business through retail stores in four business segments: prescription drugs, health and beauty care; apparel; toys and home furnishings and footwear. In accordance with APB Opinion No. 30, the footwear segment has been segregated as discontinued operations. Information about each of the continuing operation segments is summarized as follows:

($ in thousands)	1995	1994	1993
Prescription Drugs, Health and Beauty Care			
Net sales	$4,865,025	$4,330,099	$3,948,197
Operating profit (a)(b)	252,748	227,655	195,670
Identifiable assets at December 31 (c)	1,673,682	1,662,127	1,592,964
Depreciation and amortization	66,458	60,828	56,883
Additions to property and equipment (d)	78,019	102,047	104,592
Apparel (e)			
Net sales	3,055,651	3,538,928	3,395,926
Operating (loss) profit (a)(b)	(672,776)	161,087	181,922
Identifiable assets at December 31 (c)	318,991	1,528,693	1,334,026
Depreciation and amortization	85,571	79,210	75,963
Additions to property and equipment (d)	83,853	145,032	154,247
Toys and Home Furnishings			
Net sales	1,768,386	1,576,651	1,378,185
Operating (loss) profit (a)(b)	(115,688)	99,403	89,138
Identifiable assets at December 31 (c)	836,885	789,859	655,290
Depreciation and amortization	41,111	37,424	34,797
Additions to property and equipment (d)	93,183	92,332	70,948
Total continuing operations			
Net sales	$9,689,062	$9,445,678	$8,722,308
Operating (loss) profit before corporate expenses (a)(b)	(535,716)	488,145	466,730
Corporate expenses excluding depreciation and amortization (b)(f)	202,470	34,987	7,706
Corporate depreciation and amortization	4,605	2,894	3,008
Interest expense, net	54,977	32,385	23,769
(Loss) earnings from continuing operations before income taxes	$ (797,768)	$ 417,879	$ 432,247
Total identifiable assets of continuing operations at December 31 (c)	2,829,558	3,980,679	3,582,280
Corporate assets at December 31	481,479	94,613	107,746
Assets of discontinued operations	650,525	660,197	568,015
Total assets at December 31	$3,961,562	$4,735,489	$4,258,041
Depreciation and amortization - continuing operations	$ 197,745	$ 180,356	$ 170,651
Corporate additions to property and equipment	46,966	25,461	11,013
Additions of discontinued operations to property and equipment (d)	92,930	56,503	45,924
Total additions to property and equipment (d)	$ 394,951	$ 421,375	$ 386,724

(a) Operating (loss) profit is defined as total revenues less operating expenses.
(b) In 1995, includes the effect of restructuring, asset impairment and other charges.
(c) Identifiable assets include those assets directly related to each segment's operations.
(d) Excludes acquisitions.
(e) Includes Marshalls through November 17, 1995.
(f) Includes general corporate expenses as well as net expenses related to other corporate managed subsidiaries.

Five-Year Financial Summary

Melville Corporation and Subsidiary Companies

($ in thousands, except per share data)

Results for the Year	1995[a]	1994	1993	1992[a]	1991
Net Sales	$9,689,062	$9,445,678	$8,722,308	$8,592,822	$8,138,767
Wages and Compensation	1,204,285	1,176,629	1,127,056	1,083,184	1,033,393
Taxes	(36,258)	366,665	348,394	278,451	354,094
(Loss) Earnings from Continuing Operations before Income Taxes and Cumulative Effect of Change in Accounting Principle	(797,768)	417,879	432,247	242,764	475,832
(Loss) Earnings from Continuing Operations before Cumulative Effect of Change in Accounting Principle	(615,698)	243,586	262,609	134,963	280,993
(Loss) Earnings before Cumulative Effect of Change in Accounting Principle	(615,151)	307,470	331,790	133,890	346,681
Net (Loss) Earnings	(657,106)	307,470	331,790	133,429	346,681
Dividends Declared	184,294	185,351	184,934	180,324	174,517
Per Share of Common Stock					
(Loss) Earnings from Continuing Operations before Cumulative Effect of Change in Accounting Principle	$ (6.02)	$ 2.15	$ 2.33	$ 1.14	$ 2.55
(Loss) Earnings before Cumulative Effect of Change in Accounting Principle	(6.01)	2.75	3.00	1.13	3.20
Net (Loss) Earnings	(6.41)	2.75	3.00	1.13	3.20
Dividends	1.52	1.52	1.52	1.48	1.44
Book Value	14.73	22.54	21.33	19.83	20.06
End of Year Position					
Current Assets	$2,559,928	$2,650,499	$2,384,031	$2,429,772	$2,359,017
Current Liabilities	1,797,688	1,642,742	1,292,708	1,350,498	1,302,770
Total Assets	$3,961,562	$4,735,489	$4,258,041	$4,202,162	$4,074,259
Total Long-Term Obligations and Redeemable Preferred Stock	335,985	351,762	365,936	376,417	385,483
Property and Equipment					
Net of Accumulated Depreciation and Amortization	$1,114,404	$1,526,922	$1,316,877	$1,225,039	$1,126,122
Capital Additions (b)	394,951	421,375	386,724	304,345	253,072
Percentage of Net Sales					
(Loss) Earnings from Continuing Operations before Income Taxes and Cumulative Effect of Change in Accounting Principle	(8.2)	4.4	5.0	2.8	5.8
(Loss) Earnings before Cumulative Effect of Change in Accounting Principle	(6.3)	3.3	3.8	1.6	4.3
Net (Loss) Earnings	(6.8)	3.3	3.8	1.6	4.3
Return on Beginning Shareholders' Equity	(27.6)%	13.7%	16.0%	6.4%	18.7%

(a) Includes impact of special charges.
(b) Excludes acquisitions.

Operations and Officers

CVS
One CVS Drive
Woonsocket, RI 02895
Thomas M. Ryan*
President and Chief Executive Officer

Meldisco
933 Macarthur Blvd.
Mahwah, NJ 07430
J. M. Robinson*
President and Chief Executive Officer

Kay-Bee
100 West Street
Pittsfield, MA 01201
Alan P. Fine
President and Chief Operating Officer

Linens 'n Things
6 Brighton Road
Clifton, NJ 07015
Norman Axelrod*
President and Chief Executive Officer

Wilsons
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Minneapolis, MN 55426
Joel N. Waller*
Chairman and Chief Executive Officer
David Rogers
President

Footaction
3940 Pipestone Drive
Dallas, TX 75212
Ralph T. Parks*
President and Chief Executive Officer

Bob's
160 Corporate Court
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Michael A. Friedheim*
Chairman and Chief Executive Officer

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Larry A. McVey*
President and Chief Executive Officer

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Giorgio Malavolti
President

Melville Corporation

Stanley P. Goldstein
Chairman of the Board and
Chief Executive Officer

Harvey Rosenthal
President and Chief Operating Officer

Jerald S. Politzer
Executive Vice President

Jerald L. Maurer
Senior Vice President

Vice Presidents
Carlos E. Alberini,
Acting Chief Financial Officer
James E. Alward
Nancy R. Christal
Philip C. Galbo, Treasurer
Peggy Kelston
William C. Kingsford
Arthur V. Richards, Corporate Secretary
Maureen Richards, Assistant Secretary
Jeffery A. Warzel

Corporate Controller
Mary T. Hoeltzel

Assistant Secretaries
Roger Larence
Edward J. Lucey

Assistant Treasurers
Michael L. Mital
Brian M. Szames

* Also a Vice President of the Corporation.

Directors

Allan J. Bloostein[2]
Consultant–Retail and Consumer Goods Marketing

W. Don Cornwell[1]
Chairman of the Board and Chief Executive Officer of Granite Broadcasting Corporation, a group broadcasting company

Thomas P. Gerrity[1]
Dean of The Wharton School of the University of Pennsylvania

Stanley P. Goldstein[3]
Chairman of the Board and Chief Executive Officer of the Corporation

Michael H. Jordan[3]
Chairman and Chief Executive Officer of Westinghouse Electric Corporation, a diversified global technology based corporation

William H. Joyce[1]
Chairman of the Board and Chief Executive Officer of Union Carbide Corporation, a leading producer of chemicals and polymers

Terry R. Lautenbach[1][3]
Retired, formerly Senior Vice President of IBM, a multinational advanced information technology company

Donald F. McCullough[2][4]
Chairman Emeritus of Collins & Aikman Corporation, a producer of textiles and wall coverings

Harvey Rosenthal
President and Chief Operating Officer of the Corporation

Ivan G. Seidenberg[2]
Chairman of the Board and Chief Executive Officer of NYNEX Corporation, a worldwide communications company

Patricia Carry Stewart[1]
Retired, formerly Vice President of The Edna McConnell Clark Foundation, a charitable foundation

M. Cabell Woodward, Jr.[2][3]
Retired, formerly Vice Chairman, Chief Financial Officer and a Director of ITT Corporation, a diversified multinational corporation

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Francis C. Rooney, Jr.
Chairman Emeritus

(1) Member of the Audit Committee of the Board of Directors of the Corporation.

(2) Member of the Compensation Committee of the Board of Directors of the Corporation.

(3) Member of the Executive Committee of the Board of Directors of the Corporation.

(4) Retiring as of the 1996 Annual Shareholders' Meeting.

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Shareholder Information

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Transfer Agent and Registrar
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Shareholder Services L.L.C.
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Form 10-K
Form 10-K filed with the Securities and Exchange Commission is available without charge upon written request. Requests should be mailed to: Melville Corporate Headquarters, attention of Arthur V. Richards, Vice President and Corporate Secretary.

Annual Meeting
Annual Meeting of Shareholders will be held at Melville Corporate Headquarters, One Theall Road, Rye, NY 10580 at 10:00 A.M., on April 9, 1996.

Melville Corporation
One Theall Road
Rye, NY 10580